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IN THE

Supreme Court of the United States

OCTOBER TERM, 1942.

No. 48

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

vs.

JOHN STUART,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

BRIEF FOR RESPONDENT.

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INDEX.

	PAGE
Opinions below	1
Jurisdiction	1
Summary of Argument	2
Argument:	
I. The provisions of the trusts and the evidence do not support the contention of the Government in this case	3
II. There is no provision of the Revenue Act of 1934 which supports the Government's contention in this case	8
III. The law of Illinois gives no support to the Government's contention in this case	18

CITATIONS.

Berolzheimer v. Commissioner, 116 F. (2d) 628, C. C. A. 2 11

Blair v. Commissioner, 300 U. S. 5 ..... 12, 18, 19

Commissioner v. Barbour, 122 F. (2d) 165, C. C. A. 2 11

Commissioner v. Bateman, 127 F. (2d) 266, C. C. A. 1 11

Commissioner v. Branch, 114 F. (2d) 985, C. C. A. 1 11

Commissioner v. Chamberlain, 121 F. (2d) 765, C. C. A. 2 11

Commissioner v. Prouty, 115 F. (2d) 331, C. C. A. 1 11

Frank v. Frank, 305 Ill. 181 21

Harrison v. Schaffner, 312 U. S. 579 17

Helvering v. Clifford, 309 U. S. 331 ..... 2, 8, 9, 10, 11, 14

Helvering v. Elias, 122 F. (2d) 171, C. C. A. 2 11

Helvering v. Horst, 311 U. S. 112 16

Irwin v. Gavit, 268 U. S. 161 12

Jergens v. Commissioner, Commerce Clearing House B. T. A. Service, Decision 11,842-B 15

Morgan v. Commissioner, 309 U. S. 78 18

Reinecke v. Smith, 289 U. S. 172 21

Richardson v. Commissioner, 121 F. (2d) 1, C. C. A. 2 ..... 2, 3, 9, 10, 15, 17

Suhr v. Commissioner, 126 F. (2d) 283, C. C. A. 6 11

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BRIEF FOR RESPONDENT.

Opinions.

The opinion of the Circuit Court of Appeals is reported in 124 F. (2d) 772. The memorandum opinion of the United States Board of Tax Appeals is not reported officially.

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered December 19, 1941 (R. 49). The petition for writ of certiorari was filed March 19, 1942 and granted April 27, 1942. The jurisdiction of this Court is conferred by Section 240(a) of the Judicial Code as amended.

Summary of Argument.

In view of the language of the trusts and the evidence as to the intent of the grantor to make provision for his children, there is no provision in the Revenue Act of 1934 which justifies the taxation of the grantor on account of the income most of which was distributed to them and the balance of which was accumulated for the benefit of them and their issue.

Sections 166(2), 167 and 22(a) do not sustain the Government's contention in this case. Section 22(a), as interpreted in the *Clifford* case, 309 U. S. 331, is the broadest of these and if it makes the income of the beneficiaries in this case taxable to the grantor, the Government does not need the other sections which, without the help of Section 22(a) as interpreted by this Court, afford no basis for taxing the income of these trusts to the grantor. As to 22(a) the *Clifford* case falls far short of supporting the Government's contention, and the *Richardson* case, 121 F. (2d) 1, shows that, if any persons other than the beneficiaries were taxable under the *Clifford* doctrine, it would have been the grantor's wife and brother, not the grantor himself. Even if we accepted the Government's contention that the wife and brother, by reason of Paragraph Ninth of the trusts, became the real owners of the trust property and had no fiduciary duty to the beneficiaries, then the wife and brother, rather than the grantor, should have been taxed, so that the Government's own contention and theory of the case disposes of any tax against the grantor.

Paragraph Ninth must be construed with all the other provisions of the trusts, and no court would construe it as conferring a power to defeat the expressed purpose of the trusts to make permanent provision for the grantor's children and issue. If we can imagine the grantor's wife and brother attempting to terminate the trusts and turning over the trust property to the grantor, it is clear that the courts of Illinois, if appealed to, would prevent such a breach of duty.

ARGUMENT.

I.

The Provisions of the Trusts and the Evidence Do Not Support the Contention of the Government in This Case.

Nothing could illustrate better than does this case the extreme lengths to which the Revenue Bureau has carried the allocation of income for tax purpose to persons who are not the named beneficiaries of income in trust instruments. Here we have at least two intimate family groups instead of just one, and the families of the grantor's married daughters should make two more. The Government's contention is that, under Paragraph Ninth of the trusts, the wife and brother of the grantor, who are named as trustees, have been granted a power which gives them substantial ownership of the trust property, and that it may be assumed that they would or at least that they "could have transferred the corpus back to the grantor without interference by a court of equity." (Br. 17.) The conclusion is that therefore the grantor, in view of his relationship to his wife and brother, should be taxed on the income of the trusts which long before, in 1934 and 1935, had been paid to the grantor's children. What becomes of the gift tax on such an assumption is not disclosed.

The first thing to notice in regard to this contention is that, under the decision of the Circuit Court of Appeals for the Second Circuit in the case of *Richardson* v. *Commissioner*, 121 F. (2d) 1 (petition for certiorari denied by this court), the wife and brother might also have been taxed on the same income as the substantial owners of the trust property. The result is that, under the Revenue Acts and the decisions of the courts, the named beneficiaries

who received the income could be taxed, the wife and the brother could be taxed, and now, it is claimed, the grantor also could be taxed on the same income. It is not claimed apparently that they could all be taxed by the federal government at one and the same time, but, in such a case, if they lived in different states having income taxes, they might all be taxed at the same time, and the income taxes could easily amount to more than the income.

The three trusts in this case were made in 1930, long before the theories now set forth in the Government brief were thought of or suggested, and there is nothing in the evidence in this case to support the assumption that Paragraph Ninth was designed to enable the grantor to recover or control the trust property, to change the beneficiaries or to terminate the trusts. When John Stuart created these trusts he thought it wise to have some one outside his own intimate family group to assist in the supervision of the distribution of the income intended for his children. That is not an unusual attitude. Many parents believe that persons outside the intimate family group may be able better to train their children in some matters than they can do it themselves. This is particularly true in connection with money matters. A father may reasonably wish to make a provision for children which makes them independent so far as he is concerned, and yet have someone else outside the intimate family group exercise some supervision over their conduct and their expenditures. There is nothing in the record in this case which discloses any other reason for giving the brother, together with the wife, the broad powers conferred upon them by the trusts. There is no evidence to support the views which the Government attorneys are required now to imagine. Surely, it is not necessary, in order to accomplish what this grantor had in mind, to name an entire stranger as a trustee in order to avoid the arguments which Government attorneys now make. A grantor is entitled in such a case to appoint

a trustee or other person upon whom he can rely to exercise the desired supervision over the welfare of his own children. He is not required to risk their welfare in order to satisfy revenue agents that the trustee appointed probably will not do what the grantor would like to have him do in the exercise of the independent judgment required of him as a trustee.

On March 31, 1930, the respondent executed three trust agreements, one for his daughter who had just been married, Joan Stuart Scudder, one for another daughter, Ellen, who was about to be married and whose married name is Ellen Stuart Poole, and one for his son, John. In 1934, the first year herein involved, the married daughters were 30 and 27 years of age, respectively, and the son was 22 years old (R. 12, 13).

The respondent created the trusts because he felt that the daughters ought to be made independent so that they could run their homes in a reasonable way. He had been giving his children allowances, a plan of which he did not approve, particularly after marriage (R. 22, 23). His reason for appointing his wife, Ellen Shumway Stuart, and his brother, R. Douglas Stuart, as trustees with himself was that he knew that they shared his point of view in regard to the children, their needs, and how he wanted them to live, and that they would be just as "hard-boiled" in dealing with the children as he would be. He thought that the children's interests would be better served and protected by having them as trustees than by having a corporate trustee. They knew why the trusts were created and that it was done entirely for the benefit of the children. The respondent felt sure that as trustees they would resist any attempt by anyone to change that objective (R. 24, 25).

The respondent's net worth at the time when the trusts were established, outside of the property which he put in the trusts, was something over $4,000,000. The property

in the trusts was worth about $575,000 (R. 26). Each of the trusts comprised 700 shares of common stock of Quaker Oats Company, of which the petitioner was president (R. 27).

In creating the three trusts the respondent made the same provision for each of his children. A copy of one of the three trusts is reproduced in full (R. 15-19). For the first fifteen years the trustees were to pay to the child designated as the beneficiary of the particular trust so much of the net income as they in their discretion should deem advisable and to add any undistributed income to the principal of the trust. After fifteen years the trustees were to pay the entire net income to said child (Par. Fourth, R. 16). Upon the death of the child the trustees were to pay over the principal of the trust to the child's issue then living, or, if there were no such issue, then to the issue of the respondent then living, or, if there were no such issue then living, then in equal shares to Princeton University and the University of Chicago (Pars. Fifth and Sixth, R. 16, 17). The trustees were given the usual broad powers of management and administration (Par. Second). There was a spendthrift clause (Par. Seventh), a clause exonerating the trustees from liability except for fraud or willful mismanagement (Par. Tenth), a provision appointing a trust company as a co-trustee if two of the trustees should resign (Par. Eleventh), and a provision that the trust was to be governed by the laws of the State of Illinois (Par. Fifteenth).

The petitioner reserved no right to revoke the trusts, nor to change their provisions, nor was he a beneficiary of any of the trusts. He reserved a right to withdraw property from each of the trusts by substituting therefor other property satisfactory to the trustees and of a market value at least equal to that of the property so withdrawn. He also gave the other trustees, his wife and brother, the right to alter, change or amend the trust agreements. These

provisions are contained in paragraphs Eighth and Ninth, which provide (R. 17, 18):

> "Eighth. The Donor reserves and shall have the right at any time and from time to time to direct the Trustees to sell the whole of the Trust Fund, or any part thereof, and to reinvest the proceeds in such other property as the Donor shall direct. The Donor further reserves and shall have the right at any time and from time to time to withdraw and take over to himself the whole or any part of the Trust Fund upon first transferring and delivering to the Trustees other property satisfactory to them of a market value at least equal to that of the property so withdrawn.
>
> "Ninth. During the life of the Donor, the said Ellen Shumway Stuart and the said Robert Douglas Stuart, or the survivor of them, shall have full power and authority, by an instrument in writing signed and delivered by them or by the survivor of them to the Trustees, to alter, change or amend this Indenture at any time and from time to time by changing the beneficiary hereunder, or by changing the time when the Trust Fund, or any part thereof, or the income, is to be distributed, or by changing the Trustees, or in any other respect."

On August 3, 1935, each of the trust agreements was amended by eliminating paragraph Eighth and changing paragraph Ninth to read (R. 13, 20):

> "Ninth: This Indenture and all of the provisions thereof are irrevocable and not subject to alteration, change or amendment."

In 1934 the two daughters received the entire net income of their respective trusts and in 1935 they received nearly all of the net income. John received about one-fourth of the net income of his trust in 1934 and a slightly larger proportion in 1935 (R. 13, 14).

The question is whether, in view of the language of the trusts and the evidence as to the intent of the grantor, there is any provision in the Revenue Act of 1934 which justifies the taxation of the grantor on account of the

income which was in fact distributed to the named beneficiaries in 1934 and a part of 1933 and the income accumulated for their benefit.

II.

There Is No Provision of the Revenue Act of 1934 Which Supports the Government's Contention in This Case.

The contention of the Government appears to be a simple one. It is contended that no donor can escape payment of an income tax on property which he transfers to members of his intimate family group as long as such property is held or owned or enjoyed by such transferees and the intimate family group is maintained. Government counsel rely on sections 166 (2), 167 and 22 (a) of the Revenue Act of 1934 to sustain this contention, but section 22 (a) is in fact required to make good their claim, because it is necessary to invoke the intimate family group theory in order to support the contention that a transferee member of a family group who has ownership and control of such property still does not have an interest adverse to the grantor. This theory, but not in the form now asserted by the Government, was discovered by this Court to be embodied in section 22 (a) when it decided *Helvering* v. *Clifford*, 309 U. S. 331. Section 22 (a) has been a part of the Revenue Acts in substantially the same form since 1913, and if it supports the contention now made by Government counsel then there was never any reason for the enactment of sections 166 and 167. All that is contained in those sections and more too was already contained in 22 (a). Apparently neither Congress nor the Treasury Department was aware of this when sections 166 and 167 were enacted. At any rate, the full contention of Government counsel can be supported, if at all, only by section 22 (a), which includes the theory based upon the relationship of

members in an intimate family group, and it is necessary to consider the Government's complete contention.

Not only does the decision in the *Clifford* case fall short of the Government contention, but the decision in *Richardson* v. *Commissioner*, already referred to, in which case this Court denied certiorari, is inconsistent with their contention. In that case the taxpayer was the trustee of trusts created by his wife for the benefit of their children. The Circuit Court of Appeals for the Second Circuit held that the broad powers conferred upon the husband, as trustee, were sufficient to give him substantial ownership of the trust property, and that therefore there was more reason for applying section 22 (a) to tax him in such a case than there was to apply that section to tax the grantor in the *Clifford* case. This case shows that the doctrine of family solidarity is not confined to the taxation of grantors. Otherwise it was the wife, the grantor, and not the husband, the trustee, who should have been taxed in the *Richardson* case. It was not claimed that the husband did not have an interest adverse to the wife, nor was it claimed that the husband would return the property to her if she asked for it and that she must therefore be regarded as the taxpayer.

The only way of avoiding the decision in the *Richardson* case is for Government counsel to claim that the grantor in the case at bar could be taxed as well as the wife and brother, and that the right to tax the wife and brother does not defeat the right to tax the grantor. This would constitute an admission that their interests are adverse and would defeat the Government's contention so far as section 166 is concerned. As to section 22 (a) it is clear that in the *Richardson* case the tax was sustained against the husband, not because his wife was the grantor nor because, on account of their relationship, it was assumed that either the grantor or the husband or both might have been taxed. The husband was taxed because he was the substantial

owner of the property, having power to terminate the trust, and the income was to be used for the benefit of his children who were within the intimate family group.

There is no basis, therefore, for any contention that the decision in the *Richardson* case would justify the taxation of the wife, the grantor in that case, as well as the husband who had complete control of the trust property. If the grantor had been an uncle or a cousin or an aunt of the wife's and the husband had been made the trustee, with the same powers, the husband's interest would be clearly adverse to that of the grantor, and yet he would still have been taxed because the ownership and the beneficial interest would have remained in an intimate family group. The economic benefit to the husband would be just the same as it would be if he had received the property from the uncle or the cousin or the aunt and made the trust himself. In the case at bar it is the wife and brother who are claimed to have the power to do anything they like with the trust property, appropriate it for themselves or for any one else as they see fit. On that theory they should have been taxed, not the grantor.

In attempting to tax the grantor in this case the Government is confronted with a further difficulty in regard to the transfer of the property to the grantor. Under paragraph Eighth of the trust the grantor is permitted to withdraw securities in the trust only if they are replaced by other securities of equal market value. The wife and the brother, even if they were not trustees, would not be permitted to aid the grantor to disregard the provisions of paragraph Eighth and terminate the trust. That is the difficulty with the first step in the Government argument—that the wife and brother can ignore their fiduciary obligations and relieve the grantor of his obligations also.

This trust was not a temporary trust, as was the trust in the *Clifford* case nor was it a temporary reallocation of

income between husband and wife. It was a permanent provision for the respondent's children and their separate intimate family groups.

Since the decision in the *Clifford* case there have been a great many cases in lower federal courts and in the Board of Tax Appeals involving the application of section 22 (a). In some of the cases the courts have frankly expressed the difficulties encountered in applying the theory of the intimate family group. See, for instance, the following cases:

Berolzheimer v. *Commissioner*, 116 F. (2d) 628, 630—C. C. A. 2nd.

Commissioner v. *Barbour*, 122 F. (2d) 165, 166—C. C. A. 2nd.

Commissioner v. *Bateman*, 127 F. (2d) 266, 271, 274—C. C. A. 1st.

Suhr v. *Commissioner*, 126 F. (2d) 283, 287—C. C. A. 6th.

Commissioner v. *Chamberlain*, 121 F. (2d) 765, 766—C. C. A. 2nd.

Helvering v. *Elias*, 122 F. (2d) 171, 172—C. C. A. 2nd.

Commissioner v. *Branch*, 114 F. (2d) 985, 987—C. C. A. 1st.

Commissioner v. *Prouty*, 115 F. (2d) 331, 337—C. C. A. 1st.

The Circuit Court of Appeals for the Second Circuit has stated the problem as follows (*Commissioner* v. *Barbour*, 122 F. (2d) 165, 166):

"* * * When once the legal difficulties have been overcome of attributing to a grantor for tax purposes income not his under the state law, some practical rule ought to be devised which will indicate with reasonable certainty what trusts are to be taxed against grantors and will not leave each new set of circumstances to be dealt with as a fresh problem. It would seem reason-

able to say that the income of trusts which are not substantially longer than the one in *Helvering* v. *Clifford* are to be taxed against the grantor if he retains the reversion and the income of the property originally in his hands remains 'within' an intimate family group.' "

The truth is that formerly income by definition meant some payment or gain to a person who was entitled to claim it as income. Section 22 (a) was aimed at that person at any rate, no matter from what source the income came. It was the existence of that person that made the payment income. If that person could not be found and the money or other property was otherwise disposed of, it would not be income. There are many corporations which have persons listed as stockholders who cannot be found and to whom dividend payments cannot be made. The unclaimed amounts may never become income to anyone; they certainly cannot be attributed as income for tax purposes to someone not entitled to the dividends. The same thing is true of all capital investments, including trusts.

The beneficiary of a trust who is named as the person to whom income is to be paid by the trustee can certainly be taxed on that income under 22 (a), no matter how small may be the equitable interest from which the income is derived. The tax does not depend upon legal ownership of the property which produces the income, but may accrue from an "interest in such property," to quote the words of the section. The opinion in the *Clifford* case refers to page 12 of the opinion in *Blair* v. *Commissioner*, 300 U. S. 5. This Court is there referring to "the owner of the beneficial interest" in property and states that "the one who is to receive the income as the owner of the beneficial interest is to pay the tax." In *Irwin* v. *Gavit*, 268 U. S. 161, this Court also pointed out that "a gift of the income of a fund ordinarily is treated by equity as creating an interest in the fund." This Court then said (pp. 167-168):

"Apart from technicalities we can perceive no dis-

tinction relevant to the question before us between a gift of the fund for life and a gift of the income from it. The fund is appropriated to the production of the same result whichever form the gift takes."

It is obvious, therefore, that in every case of a trust which cannot be treated as a mere sham, and is in fact no trust at all, there is a difficulty in assessing an income tax against any person other than the beneficiary who is to receive the income and who is the owner of the beneficial interest. No doubt 22 (a) does tax the named beneficiary on the income from such a source, and in the case at bar it is the duty of the trustees to distribute the income as directed until a valid change is made in the trust.

The Government theory in this case seems to be that the income can be taxed to the grantor even though the named beneficiary with the beneficial interest has received it and kept it. This requires the assumption that the beneficiary has received it and kept it for the economic benefit of the grantor. Under this theory the economic benefit to the grantor continues throughout the time the beneficiary receives and enjoys the income because of the family solidarity, and that economic benefit is taxed as income to the grantor, even though the income proper has been paid to the named beneficiary who is the owner of the beneficial interest. It is assumed that the beneficiary would be willing to give the amount of the income to the grantor if he asked for it, or that the grantor derives an economic benefit if the beneficiary keeps it, but it is not denied that the beneficiary was entitled to the income, and did receive it. The family solidarity theory eliminates the possibility or the necessity of any gift either way. At the end of each taxable year an income tax would accrue against the grantor under each trust in this case without any further action on his part or on the part of the beneficiary, or on the part of the wife and brother, and in the

meantime the beneficiary would have received some kind of non-taxable income from Heaven or the Government.

The Government evidently evolved this theory in order to provide more taxes, but it may not always work that way. It may operate very satisfactorily as a gift from the Government to the old folks who would like to turn over something to younger generations in an intimate family group. A parent, for instance, has a brilliant son who is making a very good earned income, but, as he has to pay a good part of it in taxes, he cannot save as much as he would like. So this parent creates a five-year trust with the idea of having the son get some tax-free income which isn't a gift to him. The parent pays the income tax on account of the economic benefit which he derives from the income paid to the son. It may very well be less of a tax than the son would pay if the income were taxed to him, and, in any event, the tax and the income both serve to reduce the amount of property which may be subject to estate tax when the parent, at the end of one, two or perhaps three five-year trust periods, happens to die. Perhaps it is only fair that the old folks should have some of the tax terror removed from their declining years.

Very likely the Revenue Bureau has never intended that the family solidarity theory should operate in any case in which a tax advantage could be secured by the intimate family group. The purpose of the theory obviously was to prevent what is called tax avoidance. However, there is nothing in the opinion in the *Clifford* case to suggest that this theory, based upon 22 (a), was just a one-way street leading to higher taxes. It was not hinted that the one member of the intimate family group who had the highest income could be considered, for tax purposes, the recipient of all of the family income because of some economic benefit he might get from all of it. It may be an economic advantage to a father when his son or daughter becomes of

age and goes to work or gets married, but it has not yet been suggested that in that case the father, because of 22 (a), should add the income of the son or daughter to his own for tax purposes.

In the case at bar the question seems to be whether the grantor can be taxed because he originally owned the trust property and presumably pays the highest taxes in his family group, or whether the wife and brother, who are claimed as individuals to have complete control and ownership of the trust property, should be taxed on the authority of the decision in the *Richardson* case, or whether the children who actually got the income should be taxed. Perhaps the brother should be taxed on all the income because he is outside the grantor's intimate family group and may be assumed to be the real possessor of the power granted in Paragraph Ninth. Then, after the R. D. Stuart trusts were created, each brother would be taxed, not on the income of the trust created by him, but on the income of his brother's trust. Or, better still, perhaps a combination of the grantor theory and the *Richardson* case theory would permit John Stuart to be taxed on the income of his own trust and the income of his brother's trust also.

The intimate family group idea certainly does create difficulties. In Hollywood such a group might be expected to break up even within five years, and the courts in California might be expected to take judicial notice of that probability. Does a trust that isn't a trust become a trust if the family group breaks up? The Board of Tax Appeals thinks estrangement between husband and wife resulting finally in a divorce would make a difference in the application of the family group idea to income taxes. (*Jergens* v. *Commissioner*, C. C. H. Decision 11,842-B.) If later the couple remarried, then what? Obviously, without any change in a trust, the tax on the income might be due for part of a year from one member of an intimate family

group and for the rest of the year from another member. But this would mean merely more revenue agents and new Treasury Regulations requiring reports revealing intimate facts regarding intimate family groups. The case at bar also illustrates the necessity for regulations or decisions defining the extent of intimate family groups. The marriage of John Stuart's children, at the time the trusts were made, created new intimate family groups and there is no decision which holds that such family groups are to be included in the intimate family group of the grantor.

It is not necessary to burden this Court with a reference to the very many cases that have arisen in the lower courts and in the Board of Tax Appeals since the decision in the *Clifford* case. There is no case in which the problems peculiar to the case at bar have been discussed, and there is no case which considers the possibility of taxing both the beneficiary of a trust who receives the income as well as the grantor who does not in fact receive it and perhaps others.

Government counsel refer to *Helvering* v. *Horst*, 311 U. S. 112, as a case arising under section 22 (a). We are not directly concerned here with the decision in that case, but it may be well to refer to certain questions not discussed in the opinion in that case in order that the distinction between income such as wages may not be confused with income derived from trust property or other capital investments. When a person buys a bond he makes a capital investment in the whole bond, including principal and coupons. If he sells some coupons he is making a sale of part of his capital investment and may have a question of capital gain or loss to consider. If, after he sells some coupons, he also sells all of the investment he has left, the bond and the remaining coupons, he will have disposed of all of his investment and will have only a capital gain or loss question to determine. There may be some difficulty

about the question of accrued interest because of the treatment of capital gains as income, and some accrued interest may not be realized as income by anyone. No similar problem arises on the assignment of wages. Earned wages can be income only to the person who earned them. Such person can assign the amount of his wages but not his income. In the case at bar we are concerned also with a capital investment problem—income arising out of a beneficial interest in property. It is not similar to a salary or wage income; the income cannot be separated from the beneficial interest.

In the case of *Harrison* v. *Schaffner*, 312 U. S. 579, also cited by the Government (Br. 29) a new problem would have arisen if the life beneficiary, after making the gift there in question, had assigned to someone else the balance of his beneficial interest in the trust. We believe that the opinion in this case does definitely recognize the legal risk of attributing income for tax purposes to the grantor or any person other than the person designated as the one entitled to it. The decision evidently means that such a thing can be done only when it can be assumed that conditions and relationships will not change during a very temporary period.

We submit, therefore, that under the decisions of this Court and of the other federal courts the one person who clearly is not subject to an income tax in this case is the grantor. If the beneficiaries who in fact received most of the income should not have been taxed, then the only other persons who could be taxed under any decision so far are the wife and brother of the grantor. If we accept the Government's own contention that the wife and brother, by reason of Paragraph Ninth of the trust, became the real owners of the trust property then they, under the decision in the *Richardson* case, should have been taxed. That case also negatives the idea that the grantor could be taxed in their

place by assuming that they would transfer the property to the grantor if he asked for it. Their interest must be adverse to the grantor. The income tax question is disposed of by the fact of their ownership of the trust property and not by what they might do with the property. Of course we deny any such ownership. We are concerned merely to point out that the Government's own contention disposes of any tax against the grantor.

III.

The Law of Illinois Gives No Support to the Government Contention in This Case.

So far the State of Illinois has not imposed income taxes. Under the law of Illinois the word "income" means what it meant before the Sixteenth Amendment was adopted. It is not something which can be defined as income without reference to the person entitled to it.

This Court has recognized that the law of Illinois may have something to do with determining the person who may be subjected to an income tax by the Federal Government; it may determine the rights of beneficiaries under a trust and the extent of the powers of a trustee. *Morgan* v. *Commissioner*, 309 U. S. 78, 82; *Blair* v. *Commissioner*, 300 U. S. 5.

Government counsel now seem to think so, though in the court below they contended that it was a sufficient answer to our contention to say it could be assumed that the beneficiaries, being in the intimate family group, would raise no objection if the wife and brother returned the trust property to the grantor and terminated the trust. But the assumption that the married daughters are now in the grantor's intimate family group is not justified.

It is clear that the Government contentions in this case are in direct conflict with the decisions of this Court in the

cases cited above. As we have said, the Government contention means that a grantor can never escape the income tax on property which he transfers in trust if the control of the property remains in members of the intimate family group. If only persons within such family group have interests in the trust property, then they could always get together with the grantor and terminate the trust. In this case the complete control of the property is asserted to be in the wife and brother, and therefore it is claimed that the grantor has not escaped the income tax. If the beneficiaries were all members of the intimate family group then, of course, they could all join with the grantor in changing or terminating the trust, and so, in that case also, the grantor could not escape the income tax on the trust property. That practically eliminates family group trusts altogether for income tax purposes, and should also eliminate gift taxes in the case of gifts within the intimate family group. It could be assumed by parity of reasoning that the donor could always get his gifts back for the asking.

Needless to say there are no decisions in Illinois which give support to the Government theory. The courts in that state have been sufficiently familiar with controversies in intimate family groups to know that a wife may disagree with a husband regarding property rights, and that children may be only too glad to keep property that is provided for them by a parent. It is not unknown that a wife may prefer a child to her husband in property matters. The *Blair* case recognizes that transfers within a family group may result in a new income taxpayer and that the question of who shall pay the income taxes may depend upon the law of the state.

The suggestion made by the Government in this case—that "the wife and brother could have transferred the corpus back to the grantor without interference by a court

of equity" (Br., p. 17) indicates a lack of familiarity with courts of equity in Illinois. As we have said, the statement does at least indicate a recognition of the fact that a court of equity in Illinois might have something to say about it that would be of interest. We believe it would be difficult to state a stronger case for "interference by a court of equity."

In the first place the intent of the grantor is of first importance. That is shown not only by the trusts themselves but by the evidence in the record. The grantor parted with only a small fraction of his entire possessions. He did it at a time when his daughters were establishing new intimate family groups, and he did it to make them in matters of property not only independent of him but independent in such respects in their new intimate family groups. The purpose was sound, normal and wholly human. No one but a revenue agent could think of any ground for suspicion. The whole of the trust instruments testify to the creation of permanent and not temporary trusts, but with discretion vested in the wife and brother to see that the true purpose of the trusts, the welfare of the grantor's children, should be secured. Undoubtedly the trusts testify to the complete confidence which the grantor had in his wife and brother, not to enable them to terminate the trusts but to enable them to accomplish his full intent. No power to terminate the trusts is expressed and there was no occasion for considering it. The evidence shows the financial position of the grantor and the reason why in 1930 he should be particularly concerned about making permanent provision for the independence of his children. The broad powers conferred upon the wife and brother are not inconsistent with this. They indicate merely his wisdom in recognizing that unforeseen events may happen in the lives of his children and that it will be well to have some responsible persons in a position to act.

In view of this picture the authorities which counsel cite in their brief (p. 17) have no application. They are cited to show that a court of equity cannot interfere with the exercise of an unlimited power when the power is not a power in trust, but the Government's contention that the wife and brother would not be acting as trustees, although they are trustees, does not meet the difficulty. They would be violating their duty as trustees if they permitted the grantor to keep the trust property without substituting new securities of an equal value, as required by Paragraph Eighth. That is a question which the beneficiaries could raise, and there can be no doubt about the answer of a court of equity. There is no express provision in Paragraph Ninth that the wife and the brother can do what is expressly prohibited by Paragraph Eighth or can defeat the whole purpose of the trust by terminating it altogether. No such questions were presented in *Reinecke* v. *Smith*, 289 U. S. 172, which counsel cite (Br. 17). In that case there was express authority for revocation—it was specifically mentioned.

The cases cited in the opinion of the court below, and referred to in the Government brief (p. 17), are therefore directly in point. In the case of *Frank* v. *Frank*, 305 Ill. 181, the possessor of a power thought she had an absolute power and attempted to exercise it as though it were absolute, but the court held that the power was limited by the granting instrument and that she could not exercise it as she pleased to the detriment of one of her children. In the case at bar it is clear not only that the powers expressed in Paragraph Ninth are limited by Paragraph Eighth, but also that those powers, even had there been no Paragraph Eighth, would be held by a court of equity to be limited so that no power or discretion could be exercised arbitrarily to the injury of the beneficiaries named in the trust. Paragraph Ninth must be construed with all the other provisions of the trust and cannot be considered

as conferring a power to defeat the expressed purpose of the trust. Even for the purpose of collecting income taxes it could not be held that all the gifts over contained in these trusts were put in merely for the purpose of concealing an intention to accomplish some tax evasion.

We submit that the Revenue Acts and the law of Illinois permit a grantor, in the normal situation that existed in this case, to create beneficial interests in trust property for his children, and at the same time give the broadest powers to persons in whom he has confidence to act for the benefit of his children when they deem it necessary, without being held still to be the owner of the property so transferred. It has not been supposed before this that even 22(a) was designed to revolutionize the law of future interests, which was already in a state of confusion, and enable revenue agents to shift trust interests so that the largest amount of income taxes could be secured from an intimate family group. At any rate in this case, even if we accept the Government's own interpretation of these trusts, they have pursued the wrong taxpayer and the grantor must go free.

We submit that the judgment should be affirmed.

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October 16, 1942.